Regional Solicitor's Memorandum (No. BLM.ER.0659)
Dated October 26, 1989, "Federal Oil and Gas
Lease Bonding - Period of Liability"

United States Department of the Interior

OFFICE OF THE SOLICITOR
WASHINGTON, D.C. 20240

BLM.ER.0659

Memorandum

OCT 26 1989

To: Regional Solicitor
Rocky Mountain Region

From: Assistant Solicitor, Onshore Minerals

Subject: Federal Oil and Gas Lease Bonding--Period of Liability

We have reviewed your draft memorandum (attachment) on the above-referenced subject. We concur that the termination of the period of liability for a federal oil and gas lease bond does not relieve the surety of liability for improper activities that occurred during the period the bond was in effect, but whose adverse effect did not manifest itself until the bond was released. Thus, as pointed out in your memorandum, the adverse effects of a well which was improperly plugged and abandoned during the term of a bond would not relieve the surety of liability if those effects did not manifest themselves until after the bond had been released. Similarly, an applicable statute of limitations would not begin to run until BLM was actually aware or should have been aware of adverse effects of the improper activity or the improper activity itself.

For example, assume a gas well was improperly plugged in 1968, the lease expired in 1970, and the bond covering activities on the lease was released in 1970, but the adverse effects of improper abandonment did not become manifest until 1986. Because the improper activities occurred during the term of the bond, that it was released in 1970 does not affect the liability of the surety to recompense BLM for costs associated with mitigating the adverse effect. Morever, the applicable statute of limitations would not begin to run until 1986, when the adverse effects of the improper activity became evident.

We understand that some federal oil and gas lease sureties are requesting that BLM not only release the bond at the end of the term, but that BLM also cancel the bond. BLM should not agree to cancel any bond. A cancellation would imply not only that the period of liability has terminated, but also that the surety is relieved from liability for any improper activities that occurred during the period the bond was in effect, even if the adverse effects of such activities do not become evident until after the cancellation of the bond. This would leave BLM in an unprotected position should later events demonstrate that such improper

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activities occurred during the term of the bond. For this reason, BLM should state in the release that only the period of liability has terminated.

We recommend that you transmit a copy of your signed memorandum with ours attached to all Regional and Field Solicitors. If you have any questions, please contact Stephen Brown in this branch at FTS-343-4146.

Barry E. Crowell
for William R. Murray

Attachment

cc: Chief, Division of Fluid Minerals
Leasing, Bureau of Land Management

United States Department of the Interior

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DRAFT

May 4, 1988

BLM.RM.0946

Memorandum

To: State Director, Colorado State Office, Bureau of Land Management

From: Regional Solicitor, Rocky Mountain Region

Subject: Effect of Terminating the Period of Liability of Oil and Gas Lease Bonds

STATEMENT OF ISSUE

You ask the effect of BLM's terminating the period of liability of a performance bond given to assure compliance with the terms and conditions of Federal oil and gas leases. Specifically, you want to know whether terminating the period of liability means that the Bureau of Land Management (hereinafter BLM) can no longer obtain money from the surety on that bond for a lessee's breach of some condition of the lease. Suppose, for example, that a lessee had improperly plugged and abandoned an oil well, and then BLM had terminated the period of liability. BLM discovers the improper plugging two years later when there is leakage at the well site which does extensive damage to the vegetation and wildlife. Is the surety nevertheless liable for the damages?

ANSWER

Our research indicates that the surety is still liable.

ANALYSIS

As a general proposition, a bond or fidelity bond is a contract which must be construed in accordance with the terms of the contract and the intent of the parties. 12 Am. Jur. 2d § 2 (Supp. 1987). Where, as is the case here, a bond is given to ensure a statutory obligation, it is known as a statutory bond, and the terms of the statute (and implementing regulations) are considered to be incorporated into and are considered a part of the contract. 12 Am. Jur. 2d § 26 (Supp. 1987). This is so because the obvious purpose of the bond is to assure the faithful performance of all obligations and conditions by the person obtaining the bond. For example, in R. K. Teichgraeber, 96 IBLA 249 (1987), the Interior

Board of Land Appeals (hereinafter IBLA) held that BLM properly refused to release a bond "until all the terms and conditions of the lease had been satisfied, including the payment of all necessary compensatory royalty. The IBLA expressly relied on the existing regulations and lease conditions to define the liability of the lessee and the parallel liability of his surety." 96 IBLA at 252. Similarly, in O. R. Weyrich, Jr., 49 IBLA 347 (1980), the IBLA affirmed BLM's refusal to terminate a surety's liability where the lessee had not "satisfactorily plugged and abandoned" a well on the leasehold. Again, the IBLA relied upon the language of the appropriate regulation, 43 C.F.R. 3104.8, to determine the extent of liability. 49 IBLA at 348. That regulation states:

> § 3104.8. Termination of period of liability. The authorized officer will not give consent to termination of the period of liability of any bond unless an acceptable alternative bond has been filed or until all the terms and conditions of the lease have been met.

The language of that regulation is no accident. When BLM determines, to the extent that it can, that the terms and conditions of the lease have been met, it terminates the "period of liability," that is, it sets a specific time, after which no new liability may accrue. But this does not mean that the surety may deny liability for a cause of action accruing before termination of the period of liability. For example, suppose that oil company A properly plugs and abandons a well and relinquishes the Federal oil and gas lease. Suppose that company B obtains a new lease and begins reworking the well and then takes bankruptcy before completing operations. Clearly, neither company A nor its surety is liable for anything happening after the end of its period of liability. But suppose, instead, that two years after the end of company A's period of liability, the BLM discovers serious environmental damage due to company A's improper plugging and abandonment. Clearly, company A will be liable, under its former lease, to the United States for the damages it has caused. Equally clearly, company A's surety will also be liable because its liability is co-extensive with that of the lessee. The fact the period of liability has terminated means only that the exact date has been set, beyond which no new cause of action may accrue. This is equally true for the lessee and his surety, if their liability is to be co-extensive, as the statute, regulations, and lease terms require.

Had the BLM wished to release either a lessee or a surety from any liability whatsoever, it would have been a simple matter in its regulation to use the normal language used in the bonding industry to "cancel" the bond. Or, as suggested to you by one surety, the BLM could have stated in the regulations that BLM unconditionally releases the surety from all past, present, or future liability. But the BLM did no such thing. It simply sets a time beyond which no new liability or cause of action may accrue. 43 C.F.R. 3104.8.

Bonds to ensure "faithful performance" (this language is used in BLM's bond forms) commonly involve payment long after the period of liability is over, precisely because causes of action are often not discovered for several years. For example, in United States v. American Surety Co. of New York, 172 F.2d 135 (2d Cir. 1949), the court of appeals dealt with a surety bond for "faithful performance" of a postal employee beginning in 1935. The bond was for $2,000 per year, and the premiums were paid annually. Not until 1944 was the employee's embezzlement discovered. The court held that the surety was liable for the embezzlement in each year up to $2,000 per year, notwithstanding that the embezzlement or liability wasn't discovered for many years after the embezzlement took place. Likewise, in Massachusetts Bonding and Insurance Company v. Board of County Commissioners, 100 Colo. 398, 68 P.2d 555 (1937), the Colorado Supreme Court held that a surety must pay damages incurred for embezzlement between 1923 and 1934 even though the bond was renewed and paid for annually. In some cases, the cause of action related back 11 years. The court also held that the statute of limitations didn't bar the claims because the cause of action didn't fully accrue until the embezzlement became known. 68 P.2d at 557.

In sum, the liability of a surety is exactly that of the lessee for whom the surety posts the bond. To the extent that the lessee is liable after the termination or end of the period of liability, then so is his surety. Likewise, to the extent the lessee is protected by a statute of limitations, so is his surety. Should you have any further questions, please contact Lyle K. Rising of this office at FTS 776-8444 or commercial (303) 236-8444.

Lyle K. Rising
For the Regional Solicitor
Rocky Mountain Region

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